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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-154120-06
Date:
June 20, 2007

Legend:

Company =

Date 1 =

Date 2 =

$$\underline{a} =$$
b =
$$\underline{C} =$$
$$\underline{x} =$$

State =

Dear _____ :

This letter responds to your letter dated November 14, 2006, and subsequent correspondence, submitted on behalf of Company, requesting a ruling that the rental income to be received by Company from Property under the Leases is not passive investment income under § 1362(d)(3)(C)(i) of the Internal Revenue Code.

FACTS

Company incorporated under State law in Date 1 and elected to be an S corporation effective Date 2. Company has accumulated earnings and profits of approximately x.

Company is engaged in the business of farming grain crops. It owns a acres of farmland (the Property) in State. Presently, Company's day-to-day farming activities are performed by b full-time employees and a part-time employee.

Company's employees cannot continue to perform the day-to-day farming activities. As a result, Company plans to enter into crop-share agreements (the Leases) for the Property. Under the proposed Leases, Company plans to be actively involved in most management decisions. For example, Company will decide what crops to plant, monitor crop rotation, determine varieties of seeds to plant, and decide what chemicals to apply to the crops. Further, in return for 50 percent of the crops, Company will pay 50 percent of crop inputs (such as storage, chemical treatment, and seed). Company will remain liable for real estate taxes; insurance; tiling; and building repairs including maintenance of the dryers, elevator leg, grain blower and storage bins. Company's tenants will be responsible for labor and machinery. Company will be at risk for crop yields and marketing. Company plans to have c employees after it enters into the Leases.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Section 1362(d)(3)(C)(i) provides that, except as otherwise provided in § 1362(d)(3)(C), the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(1) of the Income Tax Regulations provides that "rents" means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in the active trade or business of renting property only if, based

on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based on all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

CONCLUSION

Based on the facts submitted and representations made, we conclude that the rents Company will receive from the Property under the Leases will not be passive investment income under § 1362(d)(3)(C)(i).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation. Further, the passive investment income rules of § 1362 are independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Under a power of attorney on file with this office, a copy of this letter is being sent to Company's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

/s/

Mary Beth Collins
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes